

201401229

**TO:** Mayor and Members of City Council  
**FROM:** Harry Black, City Manager  
**SUBJECT:** Department of Finance Reports for the Fiscal Year Ended June 30, 2014 (unaudited)

October 15, 2014

HB

The following report provides an overview of the City of Cincinnati's financial condition for the fiscal year ending June 30, 2014. We compare our final revenue and expenditures against the original estimates at the beginning of the fiscal year. Revenues and expenditure trends are reviewed, followed by an explanation of the General Fund's year end carry over balance. This report also includes FY2015 budget considerations for discussion.

**General Fund 2014 Fiscal Year End Balance**

As shown in the summary table below, the City's General Fund ended fiscal year 2014 with an actual carryover amount of \$18.0 million compared to the revised 2014 budget estimated at \$4.0 million, an increase in fund balance of \$14.0 million. This is primarily the result of an increase of \$5.9 million in revenue and expenditure savings of \$7.8 million. Contained in this report is a discussion on one time uses for a portion of the \$18.0 million fund balance.

	<b>FY 2014 Budget per CFS</b>	<b>FY2014 Actual</b>	<b>\$ Change</b>
<b>Resources:</b>			
Revenues	\$350,378	\$356,308	\$5,930
Transfers In	\$68	\$68	\$0
<i>Total Resources</i>	\$350,446	\$356,376	\$5,930
<b>Expenditures:</b>			
Operating Expenditures	\$372,068	\$364,310	\$7,758
Transfer Out	\$3,075	\$3,075	\$0
<i>Total Expenditures</i>	\$375,143	\$367,385	\$7,758
<b>Operating Surplus/Deficit</b>	<b>(\$24,697)</b>	<b>(\$11,009)</b>	\$13,688
Prior Year Carryover	\$26,613	\$26,613	\$0
Cancelled Encumbrances	\$2,060	\$2,400	\$340
<b>Cash Basis Carryover Balance</b>	\$3,976	\$18,004	\$14,028
<i>Less Suggested Uses:</i>			
TIF Repayment	\$0	\$4,000	
Retroactive Pay (CODE/AFSCME)	\$0	\$685	
One Time Contingency Fund	\$0	\$4,258	
Inclusion Contract	\$0	\$275	
Labor Mediation/Arbitration Reserve	\$0	\$3,377	
Cradle Cincinnati	\$0	\$250	
Performance & Analytics	\$0	\$400	
Total of Suggested Uses		\$13,245	
Net Cash Basis Carryover Balance	\$3,976	\$4,759	\$783
Cash Added to Reserve Balance		\$4,759	
<b>Net Available</b>		\$0	

What follows is a brief explanation of resources received and expenditures that occurred throughout year to achieve the ending FY2014 carryover balance.

### **Total Resources**

**General Fund Revenues** – Actual FY2014 revenues of \$356.3 million are above revenue estimates of \$350.4 million by \$5.9 million, or 1.7%. Factors that contributed to the revenues being 1.7% over the estimate are:

#### **Favorable Variances:**

- City income tax finished the fiscal year \$1.6 million or 0.65% above the FY2014 budget estimate. Income tax collections derived from employer withholdings were up 2.0% year-to-year. Corporate net profits were at their highest levels in six years, ending the year up 4% year-to-year. In FY2014, income tax collections were derived approximately 84% from withholdings and 16% from individual payments/business net profits.
- Estate tax, although repealed by the state in 2012, ended the fiscal year above projections by almost \$4.0 million. This revenue stream had always been difficult to project. However, in recent years estate tax revenue has exceeded projections and has helped to balance out other revenue streams that underperformed. In FY2015, no funds were forecasted or budgeted. Should funds be received they will be reported in the same manner as we have done in prior years. These are non-recurring revenues.
- Admission taxes were \$778,000 over estimates due to increased revenue from sporting events and stage plays. Receipts will be monitored and adjustments made to the FY2015 projections accordingly. While hard to predict attendance levels, this category has continued for several years to outperform our estimates.
- Licenses and Permit fees were up \$1.3 million based primarily on large scale building expansions occurring in uptown Cincinnati. This is project driven based on economic development initiatives.
- Fire revenues ended the year up \$565,000 based on continued strong results in the EMS billings and collections. A change in the EMS billing administrator has helped achieve intended results in efficiently billing and collecting EMS fees.

#### **Unfavorable Variances:**

- Casino tax was well below estimates. Receipts of \$8.5 million were collected versus the \$10.0 million that was originally projected versus what the casino officials had suggested to be \$20.0 million. While the funds we receive are a formula based on total gambling revenues statewide, the City receives funds as the result of being a host city and being the largest city in a county hosting one of the four statewide casinos. Gross revenues of \$300 million were projected by the local casino officials. For the first year of operations the actual gross revenues was under \$220 million. We have adjusted our FY2015 projections downward to \$8.0 million based on actual revenues and continued pressures by racinos near Cincinnati. The Ohio gambling market continues to underperform and early indications are that the market is oversaturated.
- The Local Government Fund receipts ended the year under budget. It fell short by \$670,000. The shortfall

was the result of state cuts; we are taking a wait and see approach to further cuts in FY2015. Presently we do not anticipate further material cuts for FY2015 and beyond.

- Investment income on interim funds ended the year down \$240,000. We continue to see historic interest rate lows in investment vehicles that meet the City's investment policy. Because investment yields remained low, more of the older higher returning investments matured. The inability to reinvest these monies at similar or higher rates contributed to the lower than expected rates of returns on the entire portfolio.

### **Transfers**

The net transfers for FY2014 were \$3.0 million. Transfers-in consisted of \$68,000 while transfers-out consisted primarily of monies to Bond Retirement for FOCUS 52 debt service.

### **Total Expenditures**

Actual FY2014 operating expenditures of \$364.3 million, which are a combination of actual expenditures and encumbrances were lower than the FY2014 budgeted expenditures by \$7.8 million. This total savings variance represented 2.14% of the total budgeted expenditures. Approximately, \$3.0 million in savings was anticipated in the passage of the budget. The variance in employee benefits is primarily attributed to budgeting health care premiums higher than the actual costs negotiated and paid by the City of Cincinnati. The FY2014 budget was developed and approved months in advance of the annual (December) health care insurance implementation date. In addition, employee benefits related to vacant positions and cost-of-living-adjustments (COLAs) that were budgeted but not implemented in FY2014, resulted in actual expenditures being less than budgeted. Additional departmental savings contributed to the \$4.8 million in savings.

### **Operating Surplus/Deficit**

Within a fiscal year and not including prior year carryover, if current resources exceed current year expenditures then an operating surplus occurs. If current expenditures exceed current resources then an operating deficit occurs. For FY2014, there was a budgeted operating deficit of \$24.7 million, but an actual operating deficit of \$11.0 million occurred. This was funded from the FY2013 carryover.

### **Cancelled Encumbrances**

Cancelled encumbrances are planned or anticipated expenditures that didn't materialize into actual expenditures. Cancelled encumbrances return resources back to the fund balance of the General Fund and thereby contribute to the carryover balance. During the year the Finance Department reviewed prior year encumbrances in order to achieve additional savings for FY2014 and cancelled encumbered funds accordingly. In FY 2014 actual cancelled prior year encumbrances were \$2.4 million.

### **FY2014 and FY2015 General Fund Carryover (*Cash Basis Carryover Balances*)**

As stated earlier, the FY2014 estimated carryover amount was \$4.0 million but the actual FY2014 carryover is \$18.0 million, an increase of \$14.0 million as shown on page two of this report.

### **2015 Pending Issues of Concern**

There are several budget concerns for 2015 and beyond that are noteworthy. These include the following:

- *TIF Loan Repayments* – The City pays the Cincinnati Public Schools (CPS) \$5.0 million annually as compensation for additional property tax revenues CPS would have received if the City had not authorized tax exemptions for

certain projects. In 2011, the City borrowed \$5.0 million from TIF funds to make the payment to CPS. \$4.0 million dollars remains outstanding. While the City had intended to repay this obligation over several years, the yearend financial position has allowed the City to accelerate our plans and make the entire payment. We recommend that the balance be repaid from carryover balance. An ordinance will be prepared authorizing the remaining balance to be repaid.

- *Reserve for weather and one time expenditures* – We recommend that the City will establish a special fund in the amount of \$4.3 million from carryover balance for the express purpose of providing funding for unanticipated weather events or other one time expenditures as deemed appropriate by the City Manager and approved by City Council. The FY2015 approved budget includes resources for a typical winter season. An ordinance will be prepared authorizing the establishment of this reserve.
- *Allocation for retroactive pay* - Due to the timing of the labor contracts with CODE and AFSCME the FY2014 budgeted funds intended for retroactive salary increases remained at year's end unspent. As a result these monies are contained in the unexpended balance. In August the retroactive payments were made to all parties affected. This expense totaled \$685,050. City Council previously approved an ordinance to provide these monies.
- *Cradle Cincinnati* – The high rate infant mortality continues to be problem in Cincinnati. We recommend \$250,000 for Cradle Cincinnati from carryover balance to fulfill the Mayor and City Council commitment to this program. An ordinance will be prepared to fund this program.
- *BRBS World, LLC* – The initiative to increase minority and women representation in City contracts requires additional resources to increase the effort to identify minority and women suppliers. We recommend \$275,000 from carryover balance for this initiative. An ordinance will be prepared for to extend the contract for BRBS World, LLC.
- *Labor Mediation/Arbitration* - There are pending discussion with the FOP and IAFF related to labor contracts. We recommend a reserve of \$3.4 million to be set aside for potential settlements from the carryover balance.
- *Performance and Data Analytics Initiative* – We recommend beginning the process of designing, developing and establishing an office of Performance and Data Analytics that will reside in the City Manager's office. This function will entail a value added building blocks approach that will take a couple of years for full implementation. However, the City will realize financial and operating efficiencies and savings with the execution of each building block along the way. The office will serve as an incubator for each building block and will manage all of the components from a day-to-day perspective. The various components that will be pursued in consultation with the Mayor and City Council, along with input and feedback from the City's administrative leadership (Department Heads) will include:
  - Design, development and establishment of department performance management agreements
  - Design, development and establishment of a Citistat program: data-driven Information is gathered on an array of performance indicators, including response times for things like pothole abatement, trash collection, and snow removal, as well as the prevalence of problems such as illegal dumping, vacant buildings, and sewage overflows. This information is analyzed with the assistance of computerized databases and geographic mapping to zero in on areas of underperformance. Managers from each city department then would meet with the City Manager and others to answer questions about their results.
  - Design, development and establishment of an innovation laboratory, leveraging lean government techniques: Lean Government emphasizes making government more efficient, responsive, and satisfying to citizens and employees alike while simultaneously respecting individuals and changing the way people think about government.
  - Build on the City's "Priority Driven Budgeting framework" and connecting it programmatically and technologically to performance and data analytics (Citistat).

The one-time cost for program start-up is \$400,000. An ordinance will be prepared to provide funding from the carryover balance.

- *Reserve Balances* – The Government Finance Officers Association (GFOA) recommends that local governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund. The City's goal is a total reserves amount of ten percent (10%) of General Fund revenues.  
The three components that make up the City's reserves are the General Fund carryover, Emergency Reserve and the Working Capital Reserve. The total reserve balance at the end of FY2014 was \$41.9 million (composed of \$21.5 million in Working Capital Reserve, \$2.4 million in the Emergency Reserve and \$18.0 million in carryover fund balance) and was 11.8% of actual 2014 General Fund revenues. After approval of the referenced spending plans the total reserve will be 8% which is consistent with recent balances. Working Capital Reserve at 6/30/2014 was \$21,500,000 or 6.03% of FY2014 General Fund revenue. This meets City Council policy for Working Capital reserve of between 5% and 8%.
- *Income Tax and Economic Study* – We have experienced an uptick in corporate net profits and larger than expected partnership profits. Finance has reviewed and increased their projections for FY2015 accordingly. It should be stressed that the City remains over reliant on this revenue category. The City Administration will engage the services of an economic forecaster to ascertain any changes in the local economy that might warrant us revising our estimates for FY2016 and beyond. The last comprehensive review was performed in 2012, with limited review and update performed last year.
- *Pension System* – The Mayor and City Council took dramatic and unprecedented actions to address the City's pension plan with the approval of ordinance #0038-2014, dated March 19, 2014, which authorizes the City Manager to enter into a global consent decree with the federal court, actively employed members, and retired members of the Cincinnati Retirement System (CRS). We are encouraged that an agreement can be reached which will not only address the unfunded liability but will fully fund the system within 30 years. Negotiations are ongoing and subject to a confidentiality order. All sides are working diligently towards a collaborative result. The Auditor of State continues to monitor both the progress of the global consent decree and the state of the pension system.
- *Street Rehabilitation* - The need for funding for street rehabilitation has grown. Since 2009 the condition of the City's streets have deteriorated from "good" to "fair" condition. Funding the rehabilitation of only 100 lane miles each year is not enough to maintain the streets in "good" condition. In addition, there is a great need for an additional allowance for preventive maintenance. Preventive maintenance funding will provide the necessary improvements to keep the "good" streets in the current condition while the streets rated "fair" and below are addressed through the lane mile program.
- *Fleet Capital Needs* – The City's motorized fleet has been under funded since 2007 by \$50 million. As a consequence, many segments of that fleet are well out of life cycle. Over 60% of our police cruisers and garbage trucks are not only beyond their useful life; with no replacements the only option has been to perform very costly repairs to them for continued use. A capital infusion will be required within the next budget cycle. Actual capital needs will be predicated upon a complete review of the city wide fleet.
- *House Bill (HB) 337* - was introduced in the House November 6, 2013. This Bill has continued in hearings within the House 'State & Local Government Committee'. This bill aims "to revise budgeting requirements that apply to local governments, mandate that certain actuarial standards be applied in political subdivisions that have independent retirement systems, and authorize the Auditor of State to impose sanctions on local governments that fail to comply with budget, debt, or pension requirements under state law." Among other changes, the bill requires the governing authority of a political subdivision's retirement system (practically, this applies only to the Cincinnati Retirement System) to establish a period of not more than 30 years to amortize the retirement system's unfunded actuarial accrued pension liability. If no suitable plan is adopted within 180 days of valuation, all "state funding," for that political subdivision, other than benefit assistance to individuals, must be withheld until subsequent notification from the Auditor of State to the Office of Budget and Management that a plan has been adopted.
- *House Bill (HB) 5- Municipal Income Tax Reform* - In November 2013 Substitute HB 5 was passed by the Ohio House of Representatives and referred to the Senate Finance Committee. The bill remains in committee but the

Senate is expected to consider this bill by the end of the year. The stated purpose of HB5 is to create uniform rules for income tax withholding and net profit taxation among all Ohio municipalities. It is now estimated that Cincinnati could lose \$3 million in annual tax revenue if the substitute bill is enacted. In addition to the loss of potential tax revenues, Substitute HB 5 would require Ohio municipalities to administer the tax as mandated by the Ohio Revised Code, thereby controlling enforcement policies and compromising Home Rule. The requirements of this legislation complicate rather than simplify the tax requirements and create additional administrative costs.

- *Senate Bill (SB) 282- Exempt Nonresidents from Municipal Income Tax* - SB 282, introduced in the Ohio Senate in February 2014, will prohibit municipal corporations from levying an income tax on nonresidents' compensation for personal services or net profits from a sole proprietorship. The potential loss of revenue for Cincinnati if nonresidents are exempt from Cincinnati taxation would be devastating. A rough estimate is that 70% of this city's withholding tax revenue is generated from nonresident employees at approximately \$200 million. The bill currently is ready for discussion in the Senate Ways and Means Committee.

### **Miscellaneous**

In conjunction with this year-end report, submitted herewith are the following Department of Finance reports:

1. Statement of Revenue and Expenditures for the month ended June 30, 2014
2. Graph as of June 30, 2014 presenting the General Fund's Revenue, Expenditures and Encumbrances
3. Three year comparisons of the June 30, 2014 Statement of Balances for General Fund
4. City Treasurer's Monthly Cash Reconciliation Reports for May and June 2014 and May and June monthly audit report of the accounts of the City Treasurer
5. Statement of Balances for all Funds as of June 30, 2014

By approval of this report, City Council appropriates the revenues received in the various restricted funds on the attached Statement of Balances and as stated in greater detail on the records maintained by the Department of Finance, Division of Accounts & Audits. Such revenues are to be expended in accordance with the purposes for which the funds were established.

c: Reginald Zeno, Director of Finance